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***SCOTTSDALE CITY COUNCIL***

Herbert Drinkwater, Mayor  
Councilman Greg Bielli  
Councilman James Burke  
Councilwoman Mary Manross  
Councilman Robert Pettycrew  
Councilman Donald Prior  
Councilman Richard Thomas

**CONTROLS OVER OUTSIDE  
LAW FIRM USE**

Cost to the City for contracted law firms rose steadily from 1992 through 1995. In response, the City Attorney is strengthening the Office's contract administration.

**Report No. 9515  
February 1996**



March 7, 1996

To the Most Honorable Herbert R. Drinkwater, Mayor  
and the Members of the Scottsdale City Council:

Transmitted herewith is the Controls Over Outside Law Firm Use Report No. 9515. This audit was a scheduled project approved by City Council. Janet Lowden and Preson Phillips, Jr., participated in the project.

The audit was conducted in accordance with generally accepted government auditing standards as they relate to expanded scope auditing in a local government environment and as required by Article III Scottsdale Revised Code §2-117, *et seq*, with one exception. The last peer review of the City Auditor was completed April 5, 1991. Thus we currently do not comply with the standards' three-year peer review requirement.

If you need additional information or have any questions, please feel free to contact us at 994-7756.

Respectfully submitted,

A handwritten signature in cursive script, reading "Cheryl Barcala".

Cheryl Barcala, CIA, CPA, CFE, CGFM  
Scottsdale City Auditor

Gail Crawford, CPS

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# Controls Over Outside Law Firm Use Action Plan

No.	MANAGEMENT RESPONSE		IMPLEMENTATION STATUS		RECOMMENDATIONS
	AGREE	DISAGREE	UNDERWAY	PLANNED	
1	X		X		<p>The City Attorney should:</p> <p>Expand the Office's written policies and procedures for key controls in outside legal services purchasing and contract administration, and include in the document policy and procedures for use of the committee selection process, a requirement for developing a case budget/litigation plan, and a requirement for periodic vendor audits.</p> <p>Evaluate the consistency of contractual provisions used for outside legal services.</p> <p>Develop a written ethics and conflict of interest policy, train staff about it, and document training attendance.</p> <p>Consider incorporating the City's Administrative Guideline on Alternate Service Delivery into the Office's policy and procedures and document analyses.</p> <p>Evaluate payment methods used in outside legal service contracts.</p> <p>Request that Financial Services emphasize to departments the need to consistently code expenditures for outside legal services to the correct account.</p>
2	X		X		
3	X		X		
4	X			X	
5	X		X		
6	X			X	

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# CHAPTER ONE

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Controls Over Outside Law Firm Use  
City Auditor Report No. 9515

## **Introduction**

Historically, because of the unpredictability of workload and the need for specialized expertise, the City Attorney has contracted for outside law firms to aid the City. In 1994, when the new City Attorney was appointed, she requested that we evaluate this process to assure herself that the City Attorney's Office had control of all outside counsel relationships in the City. City Council approved the audit. To answer her questions, we evaluated City use of outside legal counsel in the last three fiscal years to determine the volume of outside counsel expenditures, as well as to provide advice about improvements needed in the process. We did not evaluate the appropriateness of such use, nor did we assess outside counsel use within the City Attorney and City Court.

## **Results In Brief**

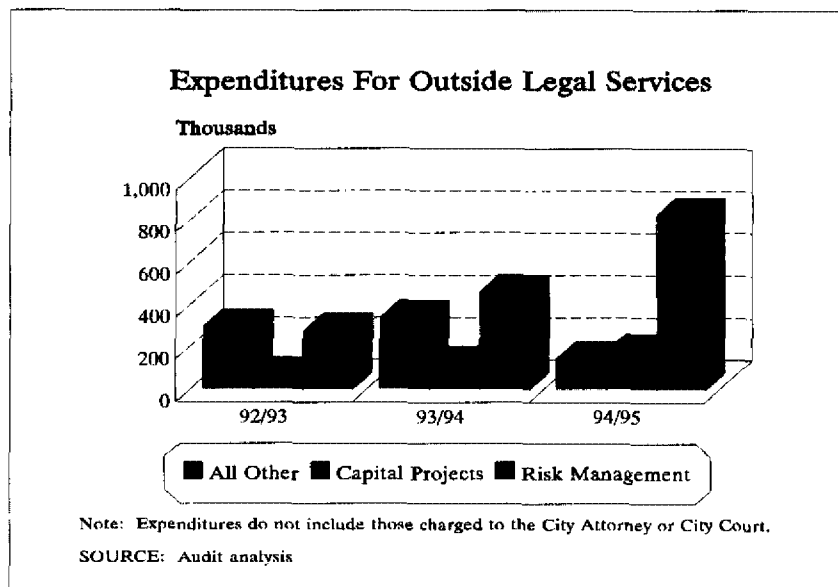
In general, departments are contracting for outside legal counsel through the City Attorney, as required, contracts are administered adequately, and the City Attorney and her staff have adequate oversight of the process. During the past year, the City Attorney has emphasized the need to strengthen both the procurement and contract administration phase of contracting out. Policy now requires attorneys to structure outside legal relationships formally, in a standard manner. Requests for Information from law firms have been initiated to create a pre-set list of qualified vendors in condemnation and real estate services. Procedures include drafting "boilerplate" provisions for contract language consistency, to ensure all necessary protections for the City are included, and establishing procedures to review outside legal counsel invoices for appropriateness. In areas of continual legal services contracting (Risk Management, Capital Projects Management, Financial Services, and Transportation), the departments also have assigned contract administrators who monitor vendor service and payments.

The City Procurement Code establishes a "separate but equal" process under the City Attorney's direction for contracting for legal services. Because of this, the City Attorney does not use Purchasing Division documentation procedures, nor are duties segregated between individuals making the selection and the approving authority. We offer suggestions about compensating controls that the City Attorney could consider, such as documenting conformance with the Procurement Code. In addition, suggestions are offered to strengthen

contract administration and improve management oversight of this growing area. One key control for management oversight requires that City staff should be instructed to always correctly code payments to outside counsel. Financial Services has taken steps to reemphasize this requirement.

## Background

The City Attorney is a Charter Officer whose department provides legal advice and assistance to the City, including the City Council and other City officials. (The City Prosecutor, whose division prosecutes misdemeanors and City Code violations, is also part of the department.) One of the City Attorney's functions is to determine when circumstances require the employment of private law firms. However, in matters involving tort (injury) claims against the City, the Risk Management director, rather than the City Attorney, selects and employs the outside attorneys who represent the City. During fiscal year 1994/95, the City spent almost \$1.2 million for outside legal services. Almost three-fourths of the total was spent by the Risk Management division, for tort litigation. (See below.)



### City Attorney Administers Outside Legal Services Contracting

Situations requiring use of outside legal counsel can arise when matters touch on an area of law in which City Attorney staff do not have particular expertise. Another situation can arise if a matter requires more staff time than the City Attorney can devote. Matters reaching the City Attorney's Office usually are issues which

potentially involve great risk, financial or legal, so that the attorneys form a "defensive boundary" for the City. Information handled by the Office is confidential and sensitive. Thus, the choice of an outside law firm to help the City is a serious one.

Because of this, and recognizing the unique professional expertise in the City Attorney's Office, the City Procurement Code requires that purchases of outside legal services are administered by the City Attorney rather than by the Purchasing Director. This requirement functions to protect the City's interests in several ways. First, outside counsel expertise will be assessed by City legal professionals before contracts are final. Second, the City Attorney should have information about all outside counsel engagements. Using this information, she can determine at what point hiring permanent City legal staff could be more cost-efficient.

Another reason why contracts for legal services are administered through the City Attorney is that selection of an outside counsel involves not only "best and final offer" considerations, but also considerations about past experience with City matters. Such experience permits seasoned legal judgment to protect City interests. Lastly, professional standards require firms to notify potential clients if attorneys have worked for opposing interests, the "conflict of interest" protection. Knowledge of all outside counsels and the matters they worked on allows the City Attorney to judge when to waive the requirement.

**Procurement  
Processes  
Used Vary**

Procurements of outside legal services follow the Procurement Code guidelines for purchases of professional services, except that the City Attorney directs the process. For informal purchases, those where the contract amount is expected to be \$10,000 or less, the attorney who will be the contract administrator identifies one or several potential law firms who could provide the needed services. The attorney develops the contract, negotiating the terms with the firm, and the City Attorney approves it. The department for whom the work is being done is part of the process, and may pay for some or all of the expenditures. According to the City Attorney, with very few exceptions, a committee selection process is used for these informal purchases.

For formal purchases, those involving \$10,000 or over, several methods of procurement have been used. An attorney might have

invited firms known to him or her to submit proposals, which were then evaluated. Alternatively, a committee might have been convened, which identified firms and invited proposals. The committee then evaluated the proposals. (As a matter of policy, all formal purchases are now evaluated by a committee convened by the City Attorney.) Law firms presently under contract to Risk Management were identified by the cognizant attorney and Risk Management director, and invited to submit proposals. For current bond counsel contracts, Financial Services issued a Request for Proposal through Purchasing, and an evaluation committee determined the best qualified firms. As the final step, City Council then approved any contract over \$10,000, as required by the Code.

Typically, after contract award, the attorney will function as the contract administrator. The contract administrator is supposed to verify service delivery and quality, check the invoices, and authorize payments. For outside legal service contracts, City Attorney staff have the necessary expertise to determine such matters. Recently, the City Attorney has developed written procedures which set out specific monitoring processes.

***Outside Counsel Relationships  
Are Stable***

Once established, City Attorney relationships historically have been stable. According to the attorneys and department staff, such long-term relationships enhance the quality of service, and reduce its costs, because outside counsel does not have to become familiar with City policy and procedures. During the three fiscal years covered by this audit, the firms and attorneys shown below have advised and assisted the City for two or more years.

**Outside Counsel**

Chapman & Cutler  
Copple, Chamberlin & Boehm  
Holloway, Odegard & Sweeney  
Jones, Skelton & Hochuli  
Edward L. Kurth (sole practitioner and with the firm of Jeffers, Brook,  
Kreager & Gragg)  
Long, Lundmark & Poppe  
Mariscal, Weeks, McIntyre & Friedlander  
Meyer, Hendricks, Victor, Osborn & Maledon  
Ryley, Carlock & Applewhite  
Snell & Wilmer  
Teilborg, Sanders & Parks

SOURCE: A/P data and audit analysis



## **Objectives, Scope, And Method**

At the request of the City Attorney, and with the concurrence of the Mayor and City Council, we undertook a performance audit of outside legal counsel fees. The audit's objectives were to assess the scope and cost of City use of outside counsel, except for the City Attorney and the City Court. The audit was planned to evaluate the adequacy of City policy and procedures regarding outside counsel use, and the effectiveness of other existing internal controls. Options to improve administration of outside counsel use were to be determined. Preliminary survey work commenced in September 1995 and concluded in October 1995. Fieldwork concluded in December 1995.

The audit scope included all outside counsel contracts signed in fiscal years 1992/93, 1993/94 and 1994/95. Contracts for outside counsel to advise and assist City Court and City Attorney in areas specific to their own functions were then excluded from the scope of the review because the audit's focus was on departmental outside counsel use. To determine what City policy for outside legal counsel contracting was, we reviewed the Scottsdale Revised Code, the Procurement Code, and internal City Attorney guidance. We reviewed the Administrative Guidelines and internal department procedures. We obtained and reviewed copies of outside counsel contracts.

Accessing accounts payable data on the Citywide system, we created a database using Access software which cross-referenced all name-identified outside counsel firms to the accounts payable data for the selected period. We had to perform additional analytic steps because we could not aggregate outside counsel fees by searching on the outside legal services account. Staff were not using that code on requests for payments for outside counsel. We then compared written contracts to legal firms paid to identify contracts for firms which potentially had not followed the prescribed process.

We also queried staff in 12 City departments about outside counsel use, and interviewed a judgment sample of contract administrators using a structured survey instrument to determine administrative procedures followed.

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# CHAPTER

## TWO

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Controls Over Outside Law Firm Use  
City Auditor Report No. 9515

### **Legal Services Procurement Should Provide Controls Consistent With Risks**

Existing practices for contracting with outside legal counsel appear adequate to protect the City from poor quality service, unnecessary expenditures, or breaches of confidentiality. Practices conform to Procurement Code guidelines for professional services contracts. City staff are coordinating legal services needs through the City Attorney. Efforts are being made to strengthen contract administration and oversight. However, by design, outside counsel contracts are developed outside the Purchasing Division, which professional literature states increases the risk that a vendor could entice an employee to make an uneconomic decision. Legal services contracts have other characteristics which the literature states make them high risk. These contracts can be:

- emergency procurements,
- sole source/non-competitive procurements,
- cost-plus-type contracts,
- with vendors which bill based on hours and/or costs, and
- incapable of being independently measured by the City.

For these reasons, we offer suggestions about methods the City Attorney could innovate to strengthen management control over outside legal services contracts including expanding her internal policies and procedures, documenting cost/benefit analyses, and designing management reports about expenditures. We also recommend that Financial Services reemphasize to City staff the importance of correctly coding payments for outside legal services to the correct account (52140).

### **City Attorney Policies And Procedures Could Be Expanded**

The City Procurement Code, and its administrator, the Purchasing Division, offer significant management controls in purchases of goods and services. Purchasing's objectives of increasing public confidence in public procurement, ensuring the fair and equitable treatment of all persons who deal with the procurement system of the City, and fostering effective broad-based competition, are documented in contract files, creating a useful audit trail. As well, Purchasing offers independent oversight, assessing contract awards and contract terms for protection of integrity and adequate competition. The purchasing of legal services is administered, as required by the

Code, by the City Attorney rather than by Purchasing. This arrangement means that contracts for legal services do not undergo the management controls such as documentation and segregation of duties which Purchasing offers. To compensate for this, the City Attorney could expand her internal policies and procedures, and make them formal, that is, dated, signed, and periodically updated. Exhibit I (shown below) lists key controls, in addition to having a written contract, which the City Attorney could address in her Office's written policies and procedures.

#### Exhibit I

##### Procurement Code Rules And Procedures

###### *General Rules For Informal Purchases Of \$10,000 And Under*

Generally, if the informal purchase must be made without adequate competition, that is, to a sole source, specific requirements apply. A sole source may be used if the Director (for legal services, the City Attorney) determines in writing that there is only one source for the required service. The contract administrator must provide written evidence and report of research to support the request. This is to be included in the contract file. If the purchase is an emergency, a written determination of the basis for the emergency and for the selection of the particular contractor shall be included in the contract file. Authorized emergency purchases over the formal procurement limit of \$10,000 shall be reported to City Council.

###### *Specific Rules*

###### *Less than \$1,000*

The contract administrator shall utilize guidelines that provide for adequate and reasonable competition established by the Director.

###### *\$1,000 to \$5,000*

The contract administrator shall utilize guidelines that provide for adequate and reasonable competition established by the Director. Contract Administrator prepares a priced Scope of Work Statement which Contractor signs.

###### *Over \$5,000 And Up To Formal Bid Limit Of \$10,000*

Committee review process is required. Contract is negotiated for services at a fair and reasonable compensation. Results in written contract signed by the City Attorney.

###### *General Rules For Formal Purchases Over \$10,000*

Purchases are exempt from the formal procurement process (of publicly advertised bids) if the Director determines, in writing, that it is not advantageous to the City. The contract administrator shall submit a written request to the Director for the use of the Committee Review Selection Process. The request shall include why the Request for Proposal process is not advantageous to the City. The Director will make the determination as to what process to use.

In addition to documenting policies and procedures about key controls, the City Attorney could document her policy and procedures for use of the committee selection process. The committee selection process is used alternatively to open public bidding through a Request for Proposal, as long as the City Attorney determines it is advantageous to the City, and documents that decision in the contract file. Legal services have been contracted for as a result of committee selections. Formally documenting Office policy and procedures required to be followed would enhance control. The steps shown below, adapted from the Procurement Code, are offered for consideration.

#### **Steps In The Committee Selection Process**

- At least three persons must serve on the committee, and be approved by the City Attorney.
- A minimum of three potential vendors shall be notified and justification for their selection shall be included in the contract file.
- A list of the potential vendors notified should be included in the contract file.
- If the evaluation committee elects to conduct the notice and evaluation verbally, detailed notes must be kept, and filed in the contract file.
- Proposals must be evaluated according to criteria set forth in the notification, and the contract administrator shall record the evaluations in a document which evidences the committee selection.

SOURCE: Procurement Code

Four final suggestions would also address management controls. We suggest that the City Attorney should consider requiring her staff to formulate case budgets or litigation plans after the decision is made to contract out. These could aid in vendor evaluation. The successful bidder also should be required to develop a plan, so that progress can be more effectively monitored. The City Attorney could incorporate the requirement for periodic audits of legal service vendors into her policy and procedures. Auditing literature has shown that billing accuracy can improve, and cost recoveries can be realized from such efforts.

The City Attorney also could evaluate whether or not contracts need to have consistent language. We found that some contracts have a

clause about counsel ethics, and name a contract administrator. Others do not. Some have specific instructions about charges and billing, and others do not. Some contract language currently in use may not address important concerns, for example, listing kinds of acceptable expenses, which would be time-consuming to check on. We saw that expenses, generally, were a small part of the cost of outside counsel (except in Risk Management), and the specificity of such detailed paperwork may add cost to the job.

We also recommend that the City Attorney reconsider the need to continue the "separate but equal" process for legal services purchasing which the Procurement Code now mandates. Purchasing offers services in contract formulation, competition, evaluation, and award which could reduce attorney time devoted to these tasks. Additionally, dual controls over the process would reduce risk exposure. Purchasing has delegated the purchasing responsibility for certain classes of professional services to the departments which use such services routinely. Purchasing's role, stated in the Code, is that of process oversight. The City Attorney might consider this as an alternative to the establishment of an analogous, local system.

***Ethics And Conflicts Of  
Interest Policy Could  
Be Documented***

Because of their fiduciary role, government employees are held to a higher standard than is usual for the private sector. City policy is that all City personnel who deal with outside businesses must avoid even the appearance of bias or conflict of interest. For this reason, City policy is that staff is to accept vendors' gifts of only nominal value, although each general manager can promulgate local policy.

State statutory provisions, incorporated into legal services contracts, put vendors on notice that conflicts of interest in contractual relationships, when discovered, will render the contract void. Because legal services contracting is high risk, the City Attorney could take steps to deter problems. We asked the City Attorney if the ethics/conflict of interest policy was included as part of her office practice and found that while City policy was assumed to be followed, there was no specific written policy nor was training offered. Ethics/conflict of interest policies and procedures should be documented in the City Attorney policy and procedures manual. City Attorney staff could be trained in these, and attestations to that effect kept on file. If they do not already, staff could sign an annual conflict of interest statement.

**Contract Administration  
Practices Could Be  
Strengthened And  
Documented**

The City Attorney has begun to strengthen not only the procurement of outside legal services but also the administration of contracts. Procedures have been drafted to guide attorneys in paying for services. Attorneys are encouraged to verify services billed for on invoices. The City Attorney Office Coordinator has been given the task of matching invoices to contracts, and tracking payments for contracts which are budgeted through the Office. "Boilerplate" provisions have been drafted to provide contractual consistency.

We suggest that further practices could provide for enhanced management control. These also could be documented in the Office's policy and procedures.

**Suggested Practices**

- administrative contracts (under \$10,000) must bear an internal City Attorney contract number
- outside counsel invoices must have the contract number on them
- checks to vendors must have the invoice number on them
- a contract administrator must be named in the contract
- the department paying for the outside counsel must track payments
- outside counsel invoices should be verified against the contract by the contract administrator
- check requisitions for payment of outside counsel invoices must charge the appropriate account for outside counsel fees (52140)

SOURCE: Audit Analysis

Another step to strengthen contract administration could be to confirm whether additional resources will be required because of contract administration, and to document the financial impact of the additional resources. For outside counsel, such resources include time taken by assistant city attorneys to act as contract administrators. Internal procedures could require staff to record the time taken for contract administration-related tasks to facilitate tracking and analysis.

As well, use of attorney time to perform administrative functions, such as invoice verification, could be evaluated for cost. It may be more cost-efficient to add an administrative staff person specifically to be contracts coordinator for the City Attorney. Case budgets or litigation plans which are required to be submitted by the outside firm, coupled with an appropriately professional coordinator, could limit the amount of time spent by attorneys verifying legal invoices.

***Alternate Service Delivery  
Evaluations Could Be  
Documented***

The City Attorney could incorporate the City's Administrative Guideline on Alternate Service Delivery into Office policy and procedures, and require documented cost/benefit analysis. The purpose of the City policy is to ensure that alternative methods for providing services are continually evaluated to improve City processes. The Guide suggests that analyses should be documented and should enable a review to track cost comparisons for the full cycle of what it costs to provide the service from start to finish.

The Guideline provides a useful way to analyze the cost of outsourcing compared to providing the service in-house. Several analytic steps could be particularly useful to the City Attorney as she assesses office staffing. First, the Guideline suggests comparing personnel service cost estimates to the City pay plan, fringe benefit rates, and overtime rates. New staff and service levels could be confirmed with similar organizations. The City Attorney could perform a benchmark study with other similar organizations to determine if the optimal method of providing services has been reached.

***Assessments Of Alternate  
Payment Methods  
Could Be Documented***

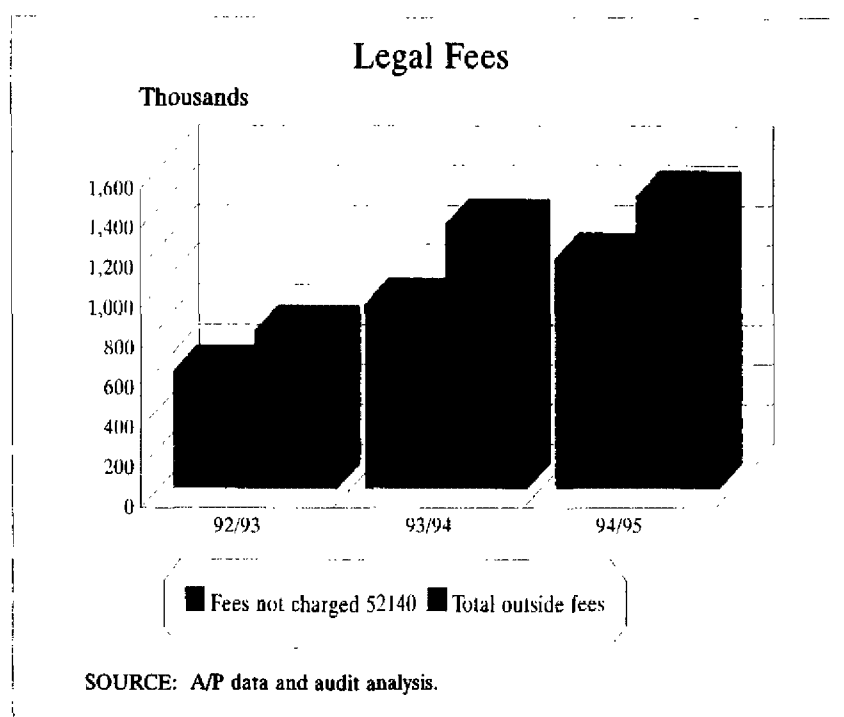
Policy could require documenting the assessment of alternate payment methods to determine whether innovative payment plans result in no loss in service quality with monetary savings. Right now, outside counsel contracts from different departments have different payment mechanisms. In Risk Management, outside counsel is paid on a per hour basis, with no contract maximum. For City Attorney contracts, outside counsel is paid on a per hour basis with a contract maximum. In Financial Services, bond counsel is paid a flat fixed fee for each type of financing project.

Law firms also charge separately for what in other businesses would be normal overhead, such as copying or travel. The City Attorney could evaluate the modernizing of payment for outside legal services, and eliminate separate payments for these expenses. They are hard to verify, and currently, legal services contracts have a variety of payment allowances.

***Periodic Reports Would  
Help Oversight***

An option which would permit the City Attorney to monitor expenditures for outside counsel would be to design periodic reports from the accounts payable database about which firms were paid, and by whom. Several steps have to be taken to make these reports easier to get. Right now, departments are not coding payments to

outside counsel to the outside legal services number on their check requisitions. While there are several reasons why this has occurred, the effect is that identifying such payments is at present very time-consuming. Because of this, accounts payable information is not realistically useful for management control. The City Attorney should request that Financial Services emphasize to departments the need to consistently code correctly.



#### Issues For Further Study

One issue which we noted that we believe requires further study, is the need to evaluate the reasons for the abrupt increase in legal services expenditures for the Risk Management division. Such expenditures grew 200 percent in the three fiscal years we audited. Because the issue was outside this audit's scope, we did not determine the cause of the increase, or whether Financial Services management is evaluating potential changes.



## **RECOMMENDATIONS**

1. The City Attorney should expand the Office's written policies and procedures for key controls in outside legal services purchasing and contract administration, and include in the document policy and procedures for use of the committee selection process, a requirement for developing a case budget/litigation plan, and a requirement for periodic vendor audits.
2. The City Attorney should evaluate the consistency of contractual provisions used for outside legal services.
3. The City Attorney should develop a written ethics and conflict of interest policy, train staff about it, and document training attendance.
4. The City Attorney should consider incorporating the City's Administrative Guideline on Alternate Service Delivery into the Office's policy and procedures and document analyses.
5. The City Attorney should evaluate payment methods used in outside legal service contracts.
6. The City Attorney should request that Financial Services emphasize to departments the need to consistently code expenditures for outside legal services to the correct account.

## **ABBREVIATED RESPONSES**

The City Attorney responded that:

1. All contracts are now accompanied by a memorandum describing the selection process. Most City Attorney contracts do not lend themselves to case budgets. We will look at the cost/benefit of vendor audits.
2. Agree. We have reviewed/modified our contracts.
3. Agree. We are in the process of drafting a policy.
4. We will consider this issue.
5. Agree. In many cases, the methods used by other departments may not be suitable.
6. Agree.

# APPENDIX

Controls Over Outside Law Firm Use  
City Auditor Report No. 9515

## A

### Management Responses

March 4, 1996

To: Cheryl Barcala, City Auditor

From: Fredda Bisman, City Attorney

Re: Response to Audit Recommendations

*1. The City Attorney should expand the Office's written policies and procedures for key controls in outside legal services purchasing and contract administration, and include in the document policy and procedures for use of the committee selection process, a requirement for developing a case budget litigation plan, and a requirement for periodic vendor audits.*

Agree with recommendation. All contracts are now required to be accompanied by a memorandum describing the selection process, including the members of the selection committee, the names of the attorneys considered for selection; how they were chosen to be considered by the committee; and the criteria used in the selection of the attorney with whom services were contracted. While case budgets are suitable for many of the cases litigated by outside counsel contracted by Risk Management, the unique nature of most of the matters for which the City Attorney contracts for legal services do not lend themselves to case budgets, although they are used on a limited basis. We will strive to increase their use where appropriate. Litigation plans are thoroughly discussed with outside counsel at the inception of the litigation, and at every critical juncture in the litigation. We will look at the cost/benefit of vendor audits, and whether they have been used successfully by other governmental and in-house law departments.

*2. The City Attorney should evaluate the consistency of contractual provisions used for outside legal services.*

Agree with recommendation. Since October of 1994 we have reviewed and modified our contract documents to provide increased consistency and will continue this process.

*3. The City Attorney should develop a written ethics and conflict of interest policy, train staff about it, and document training attendance.*

Agree with recommendation. Pursuant to this suggestion made during the audit process, we are in the process of drafting a policy. The current (unwritten) policy has been recently reviewed and discussed with the staff on several occasions.

*4. The City Attorney should consider incorporating the City's Administrative Guideline on Alternate Service Delivery into the Office's policy and procedures, and document analyses.*

Agree with recommendation.

*5. The City Attorney should evaluate payment methods used in outside legal service contracts.*

Agree with recommendation. We will regularly evaluate payment methods to assure that we are acting in the City's best interest.

*6. The City Attorney should request that Financial Services emphasize to departments the need to consistently code expenditures for outside legal services to the correct account.*

Agree with recommendation.

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